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Internal audit and oversight

Internal audit and oversight

Report of the Administrator

Summary

The present report is submitted pursuant to the arrangements agreed upon by the Executive Board. The report provides details of internal audit and oversight services provided by the Office of Audit and Performance Review for the year ended 31 December 2002.

The Executive Board may wish to take note of the report and express support for the continued strengthening and reorganization of internal audit and oversight resources.

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I. Introduction

1. The Administrator is pleased to provide the Executive Board with the seventh annual report on internal audit and oversight services provided by the UNDP Office of Audit and Performance Review (OAPR) for the year ended 31 December 2002.

2. During 2002, OAPR provided internal audit and oversight services to the United Nations Development Programme (UNDP), to the United Nations Office for Project Services (UNOPS) and to the United Nations Population Fund (UNFPA). Chapter II and annex I of the report relate to all three organizations. However, detailed discussions of the internal audit and oversight activities carried out on behalf of UNOPS and UNFPA are included as separate reports, which are being submitted to the Executive Board at its present session by the Executive Director, UNFPA (DP/FPA/2003/3) and by the Executive Director, UNOPS (DP/2003/22).

3. Effective 1 January 2003, OAPR no longer provides internal audit services to UNFPA, as the Fund has assumed responsibility for the function.

II. Developments in the UNDP oversight and accountability framework

4. In addition to OAPR, the main organizational instruments of the oversight and accountability framework are the Management Review and Oversight Committee (MROC) and the Oversight Group. In addition, the Office of Legal and Procurement Support (OLPS) plays a key role with respect to administration of the internal justice system.

5. The two main developments in 2002 include further improvements in the UNDP internal justice system and the establishment of a fraud prevention committee. These developments are briefly described below. The status of the two main oversight mechanisms in UNDP, MROC and the Oversight Group, is also summarized.

Improvements in the internal justice system

6. As reported last year, key measures were taken to strengthen the internal justice system resulting from a review, which was completed in March 2001. OLPS has taken the lead in revising and updating disciplinary procedures, setting out the rights and obligations of staff and the administration in the investigation and processing of disciplinary cases. A new policy has been drafted and approval is pending. Next steps include drafting a policy for confidential reporting of cases of suspected wrongdoing.

Establishment of fraud prevention committee

7. As reported to the Executive Board in document DP/2003/6, UNDP has established a fraud prevention committee. This committee is chaired by the Director, OLPS. In support of the United Nations initiative and in cooperation with UNFPA and UNOPS, the committee is in the process of developing a fraud prevention strategy for the three organizations by the end of 2003.

Oversight Group

8. The Oversight Group was introduced by the Administrator in 2000 to maximize and coordinate the distinctive oversight roles of the Operations Support Group (OSG) and the Evaluation Office with the role of OAPR. The three units comprising this group continue to coordinate their work to strengthen links between the various oversight tools. A key output of the group, since 2001, has been a set of indicators of country office performance, drawing on the results of

oversight activities in each of the three units. These indicators are used by UNDP senior managers to strengthen accountability for good and poor performance.

Management Review and Oversight Committee

9. MROC was established to provide the Administrator with assurance that the UNDP accountability framework is operating effectively. Whereas the Oversight Group functions at the operational level, MROC operates at a more strategic level. Chaired by the Associate Administrator, the membership includes the Under-Secretary-General, Office of Internal Oversight Services; the Assistant Administrator and Director, Bureau of Management (BOM); the Director, OLPS; the heads of the Oversight Group; and representatives of the regional bureaux. The Committee met in November 2002 to review the results of the OAPR repositioning exercise.

III. OAPR resources

10. OAPR continues to operate in a decentralized manner, with some sections located at headquarters and others in the field. The field presence consists of three regional audit service centres and two sub-offices. During the year, one of the regional audit services centres was relocated from Zimbabwe to South Africa.

11. As at 31 December 2002, OAPR had 44 authorized posts, the same as the previous year. Annex I contains details of resources and staffing activities during the year.

12. The results of the OAPR repositioning exercise will have significant implications, effective 2003, for the structure of OAPR and the numbers of posts. More detailed information on the outcome of the repositioning exercise may be found in paragraphs 17-23.

IV. OAPR initiatives to improve effectiveness and client service

New approach to audit

13. In August 2001, UNDP created a task force to review the internal audit function. OAPR proposed significant enhancements to its audit approach in response to comments and suggestions made by task force participants and country office managers. In 2002, OAPR piloted certain aspects of this new approach, including:

(a) Sharing audit criteria with country offices to improve transparency and encourage country offices to undertake regular self-assessments of performance;

(b) Completing official draft reports within four weeks of the completion of field work;

(c) Limiting the number of recommendations, per audit report, to 30;

(d) Revising the standard system for rating offices;

(e) Conducting balanced assessments of performance rather than focusing only on negative findings;

(f) Broadening the scope of the audit to include the full range of country activities, covering programme as well as financial and administrative aspects.

14. Of the 42 audits conducted in 2002, eight piloted all aspects of the new approach. While, on balance, the feedback from country offices was positive, concern remained that the scope of the country offices' audits needed to be better defined and that the profile of some OAPR audit staff was not a good fit with the requirements of the new approach.

15. To address these concerns and to ensure that, moving forward, OAPR would possess the necessary mandate, organization, and resources to maximize its value added to UNDP, OAPR initiated a repositioning exercise in August 2002 to result in a comprehensive review of the internal audit function. The key outcomes of this exercise, together with a brief description of the process, are described below.

Repositioning exercise

16. A team, independent from OAPR, carried out the repositioning exercise. The team consisted of UNDP staff and a director of internal audit of a United Nations organization. The review team completed a thorough analysis; including interviews with all OAPR staff and key stakeholders outside OAPR.

17. The key recommendations of the team, which were agreed to by OAPR, included eliminating control self-assessment workshops; adding a corporate risk assessment function; discontinuing the use of public accounting firms to conduct internal audits of country offices; recruiting audit staff with a broader range of experience, in particular, knowledge of UNDP programme activities; and strengthening the investigation, quality assurance, and information and communications technology (ITC) audit functions.

18. To implement the recommendations there will be significant changes to the organizational structure. The Management Review and Analysis Section will become the Investigation Section. Investigation resources will be strengthened by converting an existing management review post (P3 level) and an existing audit specialist post (P4 level) to investigator posts. The result will be a dedicated investigation section consisting of a chief (P5 level), three investigator posts (P4/P3 levels), and an administrative assistant. Other important changes include creating a new post, quality assurance officer (P4 level); converting an existing audit specialist post to an information and communications technology (ICT) audit specialist post; upgrading the level of existing national officer posts; and replacing existing activities of limited duration (ALD) contracts with national officer posts.

19. The multidisciplinary character of audit specialists will be strengthened through the recruitment of UNDP staff with experience in managing and monitoring programme activities. A total of six posts, at the P4 level, will be created for this purpose, within existing resource levels. These posts will be rotational, to ensure that staff have current, in-depth knowledge of UNDP programme activities.

20. The scope of country office audits will be expanded to include new corporate priorities. Performance will be assessed in twelve areas, including: country level programme; office management; knowledge-sharing; partnerships and resource mobilization; support to United Nations coordination; advisory and advocacy services; development services; human resources administration; procurement; financial resources; general administration; and ICT. Audits will assess the extent to which resources are acquired and utilized with due regard to economy and efficiency and whether management has put mechanisms in place to accurately monitor and assess whether programmes are meeting planned objectives.

21. The new posts described above will be funded largely from savings resulting from the relocation of a regional audit service centre, the availability of funds previously used for ALD contracts, and discontinuing the use of public accounting firms to conduct entire internal audits of country offices.

22. An important implication of discontinuing the use of public accounting firms to conduct complete audits of country offices is that the frequency of audit coverage will be reduced. However, OAPR believes that reduced frequency will be offset by the improved quality and scope of the audits. On average, each UNDP office will have a comprehensive internal audit once every 4-5 years.

23. The outcomes described above were reviewed and accepted by MROC as well as by senior UNDP management. Changes requiring Executive Board approval will be included in the UNDP budget submission for the biennium 2004-05.

V. National execution audit strategy

24. OAPR has taken decisive steps to address the concerns expressed by the Board of Audit in its reports for the bienniums 1998-1999 and 2000-2001. Measures undertaken during 2002 include: (i) extensive guidance to country offices to help them assess the capacity of national audit officers and/or private audit firms; (ii) comprehensive guidance regarding the terms of reference for the audits, as well as the format for the audit reports and the audit opinion; and (iii) revised criteria for selecting projects to audit that reflect the recommendations of the Board of Audit to move to a risk-based approach. The full impact of this guidance will be effective with the audit of the 2003 national execution expenditures.

25. The guidance referred to above is consistent with the recommendations made by the task force on donor practices of the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD). OAPR is also working within the United Nations harmonization task force to promote harmonization of audit practices within UNDP, the United Nations Population Fund (UNFPA), the World Food Programme (WFP) and the United Nations Children's Fund (UNICEF).

26. Finally, OAPR continues to strengthen its oversight role with respect to the annual audit exercise. OAPR formally assessed the performance of each country office using criteria such as timeliness of receipt of audit reports, scope of the audits, adequacy of the audit plan, and adequacy of follow-up action taken by the country offices.

VI. Coordination with United Nations system oversight offices

27. OAPR coordinates its activities with members of the larger United Nations oversight system, including the Board of Audit, the Joint Inspection Unit (JIU), the Office of Internal Audit and Oversight Services (OIOS), and the internal audit offices of United Nations organizations. Ongoing activities include the coordination of audit activities with the Board of Audit and OIOS and cooperation with OIOS on investigative activities. Furthermore, OAPR routinely participates in the annual meetings of representatives of internal audit offices of United Nations organizations and multilateral financial institutions, the most recent of which was held in June 2002.

28. Examples of cooperation in 2002 include: (a) consultations with OIOS on the terms of reference for the audit of projects in northern Iraq and (b) participation in a joint audit of the United Nations Joint Staff Pension Fund (UNJSPF). Working in conjunction with OIOS ensures that UNDP concerns are addressed in the course of United Nations system-wide audits. In addition, it enhances the sharing of best practices and communication between the two organizations.

VII. Internal audit and related services

A. General

29. Overall, the level of internal audit and related service outputs was relatively unchanged from that of the prior year. Table 1 summarizes OAPR output for 2002.

Table 1. Internal audit and oversight services provided in 2002

	In process as of 01/01/02	Projects initiated	Reports issued	In process as of 31/12/02
UNDP - Management reviews and advisory services	1	1	2	-
UNDP - Internal audits/reviews of functions/headquarters units	4	2	4	2
UNDP - Internal audits/reviews of projects	-	6	6	-
UNDP - Internal audits/reviews of country offices	9	42	44	7
Subtotal: UNDP audits/review	14	51	56	9
UNDP - Control self-assessment sessions	-	7	7	-
UNDP - Assessment of national execution audit reports	-	1662	1662	-
UNFPA – Internal audits/reviews	10	43	41	12
UNFPA – Assessment of national execution audit reports		542	542	
UNOPS – Internal audits/reviews	5	16	18	3
Investigation cases	39	23	50	12

B. Advisory services and management reviews

30. OAPR seeks to add value to UNDP by providing advisory services in areas where OAPR has a comparative advantage. Nonetheless, it is mindful of the potential for conflict of interest between audits and advisory activities. Key advisory services undertaken in 2002 include participating in the United Nations harmonization initiative; co-facilitating workshops on national execution procedures; and participating, as an adviser, in the UNDP ICT Decision Group. The Director, OAPR, also participates in meetings of the UNDP Executive Team.

31. Reports issued in 2002 include a management review of a regional bureau and of the JPO Service Centre. The objective of the review of the regional bureau was to assess its management oversight of country offices. The findings of the review were that, overall, the bureau exercises its oversight functions in an effective manner. The objective of the review of the JPO Service Centre was to assess corporate risks and the adequacy of systems given the recent relocation of the Centre from New York to Copenhagen. Overall, the review found that the relocation of the Centre was well managed and there were no significant corporate issues.

C. Internal audits of functions and headquarters units

32. Reports issued in 2002 include a procurement audit of the Inter-Agency Procurement Services Office (IAPSO) and audits of UNJSPF, the Bureau for Crisis Prevention and Recovery, and the Special Unit for Technical Cooperation among Developing Countries (TCDC).

33. The audit of the procurement function of IAPSO was undertaken in response to a decision by the Chief Procurement Officer to delegate authority to the Director, IAPSO, to sign procurement contracts without further review by the Advisory Committee on Procurement. The objective of the audit, which was conducted by a public accounting firm, was to assess whether risks were adequately managed and whether IAPSO procurement practices were in compliance with UNDP financial regulations and rules and related directives. While the audit made some important recommendations to strengthen procedures, no significant weaknesses were detected overall.

34. The audit of UNJSPF was coordinated by OIOS. The overall objective of the audit was to identify bottlenecks in the processing of pension fund payments and make recommendations for improvement. The UNDP portion of the audit found that, while significant delays remained, the time to process staff separations had significantly improved over the last two years. Key recommendations included exploring options for electronic submission of separation documents and better monitoring of the status of staff separations.

35. The audit of BCPR revealed that the bureau had undergone significant growth recently, placing pressures on existing systems and staff. A further complication was that many staff were new and unfamiliar with UNDP rules and procedures. As a result, the audit detected weaknesses in human resource and procurement practices; poor compliance with evaluation requirements; and, in a number of cases, approval of projects without first undergoing a formal project appraisal process. Instances were noted where the bureau, due to its heavy reliance on non-core resources, agreed to donor requests to undertake projects not directly related to its mandate and to use subcontractors recommended by donors. BCPR has recently taken steps to improve its operational capacity, including creating an operational support unit with country support specialists and human resources and programme associates. It has also established a local contracts committee and a special service agreement (SSA) review committee.

36. The audit of the Special Unit for TCDC observed that the Unit was mandated with a wide variety of responsibilities and that, as a result, it had not paid sufficient attention to mainstreaming South-South cooperation within UNDP. Operational issues noted by the audit included that there was a lack of clarity regarding project management responsibilities for a number of projects executed by UNOPS; and that a number of projects funded by the Perez-Guerrero Trust Fund did not comply with regular UNDP programming procedures. The audit also noted that the Special Unit did not fully realise opportunities for earning extra-budgetary income. The management of the Special Unit agreed to take action to address the audit observations.

D. Internal audits and reviews of UNDP projects

37. OAPR undertakes project audits only on an exceptional basis. In general, where UNDP directly executes projects OAPR practice is to audit project expenditures as part of its broader audit of the office's activities. However, where project expenditures are significant or there are other risk factors, OAPR carries out special project audits, either directly or through public accounting firms. In 2002, three audit reports were issued covering two projects in Cambodia, nine projects in East Timor, and 32 projects in northern Iraq. In addition, an audit of five nationally executed projects was carried out at the request of a UNDP office and the government concerned.

38. The projects located in northern Iraq are referred to as the Electricity Network Rehabilitation Programme. In 2002, OAPR contracted with a public accounting firm to carry out a financial audit of projects (covering the 2001 expenditures and 31 March 2002 inventory and cash balances); as well as an internal audit of operations.

39. As noted in the audit report, a key challenge faced by Programme management was restrictions on number of international staff entering Iraq. At the time of the audit the arrival of 57 personnel, of which 48 were technical specialists, was on hold pending receipt of entry visas. The audit report also highlighted the risk of financial loss given that significant levels of assets were not insured. Programme management was aware of the risk, but believed the risk was outweighed by the bigger risk of not having the equipment on site when required, which would result in the immediate interruption of project activities. In order to reduce the impact of a possible loss, however, management has dispersed the equipment to a number of locations.

40. The audit made a number of recommendations to strengthen the transparency and fairness of the procurement process, including: ensuring consistent treatment of incomplete bid forms; stipulating a time frame for acceptance of the contract; documenting reasons for inviting companies more than once for related projects; and ensuring that only one purchase order is issued where goods are ordered from the same vendor within a short period of time. In addition, the audit recommended that, given the strategic importance of spare parts management, an inventory manager with considerable industry experience should be hired. Management advised that they accepted the recommendations.

41. In 2002 OAPR contracted with a public accounting firm to carry out a financial audit of nine projects (covering the 2001 expenditures and 31 August 2002 inventory balances) directly executed by the UNDP country office in East Timor. The audit noted extensive operational weaknesses in the areas of finance and inventory, which office management agreed to address on an urgent basis.

42. OAPR also contracted with a public accounting firm to carry out a financial audit of two projects (covering the 2001 expenditures and the 31 March 2002 cash and inventory balances) directly executed by the UNDP country office in Cambodia; and an internal audit of the implementing agency, the Cambodia Mine Action Centre (CMAC). The audit noted that the follow-up of the recommendations made the previous year was satisfactory. A key new recommendation, directed to CMAC, was to strengthen the internal quality audit function and the management of the equipment inventory.

43. On an exceptional basis, OAPR carried out an audit of five nationally executed projects at the request of a UNDP country office and with the agreement of the government concerned. The objective of the audit was to certify the project financial reports for the period 1 January 2000 to 30 September 2001 and to review the management structure and internal control systems of the projects. The audit found that national execution had been implemented in the absence of a common understanding of a control framework, which had led to a governance and control vacuum where transactions were concluded without being governed by either government policies or UNDP policies. Also, a capacity assessment of the executing agency was not carried out prior to the start of project activities. Recommendations included preparing a manual to establish a common understanding of the control framework; holding periodic meetings between the government and the UNDP office to monitor and follow up on problems; and reassessing the current portfolio of ongoing projects to ensure that they are aligned with the objectives of the country programme. The government and the UNDP office agreed to implement the recommendations.

E. Internal audits and reviews of country offices

44. During 2002 OAPR issued a total of 44 internal audit reports of country offices (29 full scope and 15 limited scope). A public accounting firm contracted by OAPR conducted the limited-scope audits, which focused primarily on compliance with UNDP policies and procedures in the areas of procurement, recruitment, and finance. The 44 internal audit reports contained 1 336 recommendations, of which 1 264 (95 per cent) were accepted by management and have been or are being implemented. The remaining 72 (five per cent) are being reviewed by OAPR and, where appropriate, will be brought to the attention of UNDP senior management for follow-up action.

45. OAPR assessed each office's performance according to a three-point rating system. As part of new approach to audit adopted by OAPR, effective 2002 the rating scale was changed from a five-point scale to a three-point scale. (See annex II for the definitions of the new standard audit ratings and the new definition of performance.) Table 2 shows the breakdown by region and by overall rating of the 44 internal audit reports issued in 2002.

Table 2. Internal audit reports issued in 2002, by region and rating

Region	Satisfactory	Partially satisfactory	Deficient	Total
Africa – full-scope audits	-	8	2	10
Arab States – limited-scope audits	3	3	-	6
Arab States – full-scope audits	-	-	1	1
Asia and the Pacific – limited-scope audits	6	3	-	9
Asia and the Pacific – full-scope audits	1	-	1	2
Europe and the Commonwealth of Independent States – full-scope audits	6	1	-	7
Latin America and the Caribbean – full-scope audits	2	5	2	9
Total	18	20	6	44

46. Offices rated as deficient declined from the prior year – six in 2002 versus ten in 2001. For each of the six offices assessed as deficient, OAPR analysed the major factors contributing to the ratings and found no evidence of systemic problems. Rather, many of these offices operate in difficult circumstances and require a corporate mechanism to address the problems noted by audits. As reported last year, BOM has taken steps to provide this corporate mechanism. For example, in 2002 BOM organized several missions to country offices, consisting of headquarters and country office staff, to provide special assistance.

47. Many of the issues identified in the country office audit reports are similar to those identified in prior years. UNDP continues to take action to address the root causes of the problems. Key actions include the implementation of a new corporate software package, measures to increase awareness of internal controls among UNDP staff, and a comprehensive review of UNDP policies and procedures. These actions are described in more detail below.

48. The UNDP ICT strategy, including implementation of a new corporate software, was presented to the Board in DP/2001/21. During 2002 considerable progress was made toward implementing the strategy, including the selection of Enterprise Resource Planning (ERP) PeopleSoft as the new corporate software. UNDP is following a "fast-track"

approach to implementing ERP PeopleSoft, and expects to implement a number of key modules effective 1 January 2004, including general ledger; accounts payable; accounts receivable; procurement; treasury, assets; and human resources (local staff). Additional modules will be implemented throughout 2004 and 2005, including human resources (international staff), activity based management and balanced scorecard. When implementation is complete, PeopleSoft will support all major UNDP business processes including results-based management and project management. It will improve internal control in three respects. First, it will introduce system-driven controls over these processes. Second, it will enhance the ability of OAPR and other headquarters units to monitor country-office operations and hold managers accountable for poor performance. Third, the accompanying re-engineering of business processes is expected to contribute to a simplification of UNDP policies and procedures, which will facilitate compliance.

49. During the year, OAPR contributed to raising awareness of internal controls through publication of the new country office audit guide on its website and encouraging offices to make use of it for self-assessments; and through its co-facilitation of a regional workshop on national execution procedures. A key next step will be the introduction of one-day workshops, which OAPR will conduct at the start of every audit, to discuss with staff the importance of internal control and to help identify solutions to issues raised by staff. OAPR hopes to introduce these workshops by the end of 2003.

50. In addition, awareness of internal controls has been strengthened through the new Management Practices Network. This network is an electronic forum that has improved internal control by making it easier for staff throughout UNDP to seek guidance on solving operational problems. In 2002, staff used this forum to obtain guidance on issues relating to the management of foreign exchange risk, salary scales for national consultants, and electronic banking procedures.

51. In 2002 UNDP initiated a comprehensive review of its policies and procedures. There is widespread recognition that many of the issues uncovered by audits result from complex, unclear and difficult to find policies and procedures. This situation is the result of the rapid change UNDP has undergone in recent years, and the tendency to revise policies and procedures using email rather than by making changes to the underlying manuals. To address these problems and to prepare UNDP for the implementation of PeopleSoft, UNDP recently announced a new policy on prescriptive content management. Key aspects of this new policy include moving all existing documentation to a single electronic platform and outlining a new work-flow process for approving changes to prescriptive content.

Summary of findings in human resources, procurement, programme, general administration and office automation

52. Generally, country office audits found that human resources were appropriately managed. However, in some offices there continued to be problems with the administration of SSAs and service contracts, including lack of competitive recruitment, payments without evaluations of performance, and lack of medical clearance. For the most part, these issues will be addressed through comprehensive revisions to the policy framework for contracting individuals, which will provide country offices with clearer guidance to address the primary risk areas.

53. As noted in prior years, UNDP lacks an organization-wide system for recording personnel contracts and calculating payroll. As a result, salary payments must be made manually, allowing for errors and the overriding of controls. In addition, UNDP has had difficulty fulfilling its mandatory reporting obligations to the United Nations system. These problems will be addressed by the implementation of PeopleSoft effective 1 January 2004. Similarly, audit observations concerning purchase orders (such as the lack of pre-numbering,) and circumventions of internal controls, such as payments for goods without documenting receipt of goods, will be addressed by PeopleSoft. Finally, audits noted that some offices do not systematically keep records of vendor performance, increasing the risk that poor vendors may be re-selected.

Guidelines for evaluating vendors were recently incorporated in the UNDP Procurement Manual. In addition, a vendor performance database is being addressed as part of the implementation of PeopleSoft.

54. Many country offices have not yet fully implemented the new concepts of committing officers and verifying officers introduced by UNDP in 2000. Similarly, many offices fail to properly delegate authority for entering into contracts including vendor contracts, SSAs, service contracts, and ALD contracts. Problems revealed by audits included a failure to formally communicate the responsibilities of committing and verifying officers, designation of inappropriate staff as committing and verifying officers, delegation of authority not communicated in writing, and lack of follow-up to ensure that delegated authorities were properly carried out. To address these problems, UNDP should provide detailed guidance to country offices at the operational level. Again, it is expected that the implementation of PeopleSoft will have a positive impact on the UNDP internal control framework.

55. For the most part, audits found that country offices conduct competitive procurement processes. However, isolated problems were noted in some offices concerning procurement under $30 000 and improper approval of waivers for procurement under $100 000. These problems stemmed from a lack of understanding of UNDP procedures, which require that a formal competitive process be carried out for procurement under $30 000 even though the process need not be formally reviewed by the local Contracts Committee. Similarly, many offices were not aware that all waivers of competitive procurement over $30 000, must be approved by the Chief Procurement Officer. It is expected that the implementation of PeopleSoft will facilitate the monitoring of procurement activity by OLPS. In addition, awareness of procurement policy was reinforced recently through the introduction, effective 4 March 2003, of a new local committee to replace the existing local Contracts Committee, the SSA Committee and the Local Property Survey Board. The terms of reference for this new committee were communicated to UNDP staff.

56. Programme management was also generally in line with UNDP procedures. While some problems persisted, such as difficulties in obtaining information from executing agencies (including final expenditure reports, annual inventory reports, and quarterly financial reports), these were somewhat reduced compared to prior years. Some of the PeopleSoft modules should help to address these problems, such the project inventory module that will facilitate headquarters oversight of project inventory records.

57. With respect to office automation, recurring issues included back-ups not kept offsite; untested or non-existent disaster-recovery plans; and unsecured access to server rooms. While these observations expose risks, in general they had no impact on country office operations in 2002.

Administration of project offices where UNDP executes projects directly

58. As noted last year, those country offices involved in executing projects directly would benefit from additional corporate guidance on issues such as setting up project bank accounts and leasing project offices. While UNDP has prepared direct execution guidelines, these need to be revised to reflect lessons learned and full coverage of operational issues. UNDP will revise the guidelines as part of the broader review of prescriptive content.

Problems arising from increased reliance on non-core resources

59. UNDP has evolved into an organization that is funded from a number of sources – a multi-funded organization. While there are many benefits to being a multi-funded organization, internal audits have revealed a number of transitional issues, the most significant of which are briefly described below.

60. Increasing reliance on non-core resources have strained traditional corporate systems, making it difficult for UNDP to monitor accurately the cost of country-office operations and the levels and types of human resources used; to prepare donor reports where donors have varied reporting requirements; and to report financial information in currencies other than dollars. UNDP anticipates that implementation of PeopleSoft will help it better address some of these demands.

61. Since extra-budgetary resource inflows are unpredictable, office management must rigorously monitor the financial status of extra-budgetary activities, scaling them up or down according to changes in the level of extra-budgetary income. While the vast majority of offices achieve this and ensure that commitments do not exceed available income, volatility in extra-budgetary resource inflows increases staff uncertainty and makes long-term planning more difficult.

62. Internal audits noted instances where offices initiated project activities in the absence of a contribution but where the donor concerned had pledged support. While there is a small risk that UNDP could incur a financial loss should such donors fail to honour their commitments, the offices concerned believe that flexibility is necessary to encourage the donors concerned to work with UNDP. To minimize the risk of financial loss, UNDP has started to establish formal non-core reserves. For example, a non-core reserve was recently created for European Union-funded projects.

63. Cost recovery of non-core activities remains a major issue. While UNDP is well aware of the principle that core resources must not subsidize non-core, implementation is nonetheless complicated by a lack of good costing systems to accurately track the cost of core and non-core activities. UNDP has for some time tried to define a new cost-recovery policy that provides for an adequate recovery of the cost of non-core activities while at the same time maintaining cost-recovery rates at levels acceptable to non-core donors. The current policy is that three to five per cent of each non-core contribution should be applied to the costs of the related non-core activities. However, this policy does not extend to the recovery of costs incurred by UNDP in providing implementation support to non-core funded projects. Because the current policy is somewhat outdated and does not cover all aspects of cost recovery, many offices are unclear as to the appropriate mechanism for recovering the costs of their non-core activities. A draft policy reflecting the comments of the recent JIU report on cost-recovery is under consideration and the policy is expected to be formally approved in 2003.

64. Pressure to accept special donor conditions has become a significant corporate issue. While UNDP strongly encourages donors to use its standard cost-sharing and trust fund formats, donors are increasingly requesting exceptions. UNDP is sympathetic to need for these exceptions and works with donors to find solutions, but additional transaction costs for UNDP frequently result. For example, some donors insist on conducting their own evaluations and audits of the activities they fund, and these place a burden on country offices that must also undertake the evaluations and audits required by UNDP policy. Furthermore, a recent agreement between the Global Fund to fight AIDS, Tuberculosis and Malaria allows for representatives of the Global Fund to undertake reviews of the financial management systems of UNDP country offices. Additionally, in a few cases, country offices have agreed to donor requests to use a particular consultant or contractor without undergoing a competitive process.

F. Follow-up of audit recommendations

65. OAPR requires that all offices systematically report on the implementation status of recommendations. OAPR verifies these self-assessments, as a matter of course, during the next audit of the office. For those offices where serious deficiencies are noted, OAPR verifies that key recommendations were implemented within a reasonable period of time, either through a follow-up audit or a desk review of supporting documentation.

66. In 2000, OAPR introduced a web-based tool, referred to as the Comprehensive Audit and Recommendation Database System (CARDS), to facilitate the tracking and monitoring of audit reports and recommendations. Initial compliance was low, but recent improvements in user-friendliness and follow-up by OAPR resulted in improved compliance. Of the 40 country-office audits that took place in 2002, 32 used CARDS to report on the implementation status of recommendations.

G. Analysis of audit reports for national execution projects

67. During 2002, OAPR received and reviewed 1 662 project audit reports of national and non-governmental organization (NGO) expenditures for 2001. The audit exercise was assessed for 118 country offices and letters summarizing the assessment were sent to the resident representatives and copied to the regional bureaux, OSG and the Comptroller's Office.

68. OAPR assessed the audit exercise according to six criteria and assigned ratings of either satisfactory, partially satisfactory, or deficient for each criteria. The ratings were aggregated to determine an overall score. Of the 118 offices evaluated only nine were assessed as deficient, generally because the audit reports were significantly late or because the office failed to submit an action plan for following up the audit findings of the previous year. This is a slight improvement over the prior year where 12 offices were assessed as deficient. The total expenditures of the nine deficient offices was approximately $7 million (out of total expenditure of approximately $1.5 billion)

69. Based on its review of project audit reports, OAPR summarized the significant audit findings by project and by country office. The results were communicated to country offices and regional bureaux for information and follow-up. The majority of adverse audit findings concerned lack of competitive recruitment and procurement, poor record-keeping, and non-compliance with mandatory monitoring requirements.

70. One audit report identified a fraud. The fraud, totalling approximately $ 45 000, was carried out by the project accountant by forging the signature of the project coordinator on cheques. At the time of the audit, the project accountant had already been detained by local authorities.

H. Investigation cases

71. There were 39 cases in progress at the beginning of the year, all of which were closed during 2002. An additional 23 cases were opened during the year, of which OAPR closed four after a brief investigation failed to determine any basis for the allegation. The remaining 19 cases are summarized below.

(a) Five cases concerned abuse of authority by senior officers, misconduct, mismanagement of projects and/or misuse of programme resources;

(b) Eight cases involved various types of fraud or attempted fraud, including the medical insurance programme and the rental subsidy benefit;

(c) Two cases involved visa fraud; and

(d) Four cases related to procurement or contracting irregularities.

72. Of the 19 cases described above, 12 were ongoing as at the end of 2002.

Annex I. OAPR: organization and resources in 2002

73. Overall, the organization and level of resources in 2002 were largely unchanged from 2001. A breakdown of the authorized posts, by section, is provided in table 3.

Table 3. Authorized posts as of 31 December 2002

	Total	Director	Chiefs	Auditors	Audit assistants	Support
Office of the Director	3	1	-	-	-	2
Internal Audit Section	9	-	1	5	2	1
Management Review and Analysis Section	5	-	1	2	2	-
Audit centre – Malaysia	4	-	1	2	-	1
Audit centre – Panama	4	-	1	2	-	1
Audit centre – South Africa	6	-	1	3	1	1
Subtotal	31	1	5	14	5	6
UNFPA Audit Section	6	-	1	3	-	2
UNOPS Audit Section	7	-	1	5	-	1
Total	44	1	7	22	5	9

74. Only two OAPR posts, both located in the UNOPS audit section, were vacant at the beginning of the year. Both posts were filled early in 2002.

75. Three audit positions in the Internal Audit Section and one in the Malaysia regional audit centre were vacant for much of 2002. Recruitment against these posts was postponed pending the outcome of the OAPR repositioning exercise. In addition, effective 1 December 2002, five posts in the Africa regional audit centre became vacant due to the relocation of the centre from Zimbabwe to South Africa. These posts remained vacant at the end of 2002.

76. The post of Chief, UNOPS Audit Section, became vacant with the retirement of the incumbent in August 2002 and remained vacant at the end of the year.

77. During 2002, as in 2001, audit staff resources were supplemented with public accounting firms in two regions (Asia and the Pacific and Arab States), and with individuals on ALD contracts in the other three regions. Of the 12 individuals on ALD contracts, seven are located in the regional audit service centres and five are out-posted to sub-offices in Slovakia and Côte d'Ivoire. Ten of the ALD contract holders provide audit services to both UNDP and UNFPA and two to UNDP only.

78. As indicated earlier in this report, in 2003 significant changes will take place in the organization of OAPR. These include discontinuing the use of public accounting firms to carry out internal audits, and the transfer of the UNFPA Audit Section to UNFPA.

Annex II. Definitions of standard audit opinion ratings used by OAPR

Definition of performance

79. Within the operational audit context, performance refers to the economy, efficiency, and effectiveness of operations under the control of management. Operational audits assess the extent to which resources are acquired and utilized with due regard to economy and efficiency, and whether management has put in place mechanisms to accurately monitor and assess whether programmes are meeting planned objectives. Operational audits do not report on the achievement of results.

80. Performance also refers to the manner is which activities are conducted – i.e., whether they are conducted in accordance with UNDP values. UNDP values encompass the notions of prudence and probity, as well as the necessity of taking acceptable risks.

Rating	*Definition*
Satisfactory	In general, controls were in place to ensure that operations are economic, efficient, and effective; and that activities are conducted with due regard to UNDP values. Any weaknesses identified were not significant enough to compromise the overall performance and the control environment. The range of corrective actions required by management is moderate.
Partially satisfactory	The majority of key controls were applied. However, some significant control weaknesses were identified. Timely corrective action by management is required.
Deficient	Control weaknesses identified were widespread or were significant enough to have a negative impact on performance. Management needs to take immediate corrective action to improve the control environment.

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Internal audit and oversight

Report of the UNDP Office of Audit and Performance Review and the Project Services Audit Section to the Executive Director of UNOPS on internal audit services in 2002

Summary

The internal audit of operations of the United Nations Office for Project Services (UNOPS) is carried out by the Project Services Audit Section (PSAS) of the UNDP Office of Audit and Performance Review (OAPR). This report presents PSAS findings in relation to 19 audit assignments in 2002 for which reports were issued. The Executive Board may wish to take note of this report.

I. Introduction

1. Pursuant to the Memorandum of Understanding between UNOPS and the UNDP Office of Audit and Performance Review, the internal audit of UNOPS operations was carried out by PSAS in 2002. PSAS has seven posts comprising a chief, five audit specialists and an audit assistant. In 2002, two of the audit specialist posts were vacant for part of the year (one was filled in mid-May, the other in mid-July), and one audit specialist post devoted exclusively to the management service agreement (MSA) audit was vacant during the entire year. At end of August 2002, the Chief of PSAS retired and the related post was still vacant as of 31 December 2002.

2. In line with the approved annual audit plan for 2002, OAPR conducted a total of 19 internal audits covering operational activities in the field and at headquarters, as

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well as those under the MSA modality. Brief summaries of these audits are presented below.

II. Headquarters audits

3. At headquarters, five audits were carried out, comprising the following: (a) a desk audit of non-expendable property in UNOPS decentralized offices; (b) a horizontal audit of the submission to the United Nations Joint Staff Pension Fund (UNJSPF) of separation documents and other data by UNOPS; (c) a desk audit of the administrative expenditure under Integrated Management Information System (IMIS) code "organizational unit 8001"; (d) a review of financial forecasting; and (e) the audit of financial authorizations to the field, which was started in December 2002.

4. There were no major areas of concern relating to the above audits of headquarters functions. The special circumstances of the UNOPS budget reduction exercise of 2002, however, necessitated a departure from the usual planning process, requiring the financial forecasting process to be completed within a short two-week period, followed by an iterative finalization of the budget reduction exercise. OAPR found the planning process to be inadequately documented, with no formal procedures or instructions issued for the preparation of the annual business plan, either at organizational or divisional levels. As for the 2001 delivery forecasts, OAPR considered them inflated and attributed the large shortfall in actual delivery to optimistic forecasting by UNOPS and to unforeseen budget reductions and delays in budget approvals by some UNOPS clients. The point was also raised that division chiefs should be held accountable primarily for income rather than delivery targets, as income is a closer barometer of whether the self-financing objective will be met than delivery alone.

III. Field audits

5. There were seven field audits comprising the following seven activities: (a) management audit of the project Apoyo a la ejecución de la reforma judicial (GUA/99/014); (b) management audit of the project Support to Human Rights Operation in Colombia (COL/01/RB4); (c) management audit of the project Bi-communal Development Programme (CYP/98/001); (d) special audit of the project Comprehensive Disabled Afghans' Programme (AFG/96/006) and (AFG/00/018); (e) horizontal audit of UNOPS procurement activities in northern Iraq; (f) management audit of the Global Environment Facility (GEF) Small Grants Programme (SGP) country allocation under project number BOT/98/G52; and (g) management audit of the GEF/SGP country allocation under project number MAR/98/G52.

6. OAPR considers the overall level of internal control to be satisfactory with respect to the audits of GUA/99/014, COL/01/RB4 and procurement activities in northern Iraq. Nonetheless, some improvements in operational activities were identified. Examples of include: (a) for GUA/99/014, the need to improve compliance with certain reporting requirements to the Government; (b) for COL/01/RB4, the need for timely up-to-date expenditure information, and to define fully the degree of UNOPS involvement in the provision of support services at an

early stage in either the memorandum of understanding or the project document; and (c) for procurement activities in northern Iraq, the need to ensure that the reservation of funds covering a requisition for goods or services is always taken into account at the field level, and to strengthen cash payment documentation.

7. With regard to the audit of CYP/98/001, the unusual political environment and the absence of a country office in Cyprus were acknowledged in the audit report as having a significant effect on the implementation of project activities. A main issue is the need to revise the project document because it does not reflect realities, current arrangements, or the intentions of the parties involved, particularly the links to grant agreements signed between the United States Agency for International Development and UNDP, as well as those relating to budgetary aspects, the role of UNDP in project implementation, and the terms of reference of the programme steering committee.

8. A special audit of projects AFG/96/006 and AFG/00/018 was carried out at the request of UNOPS management, considering the lack of clarity on arrangements and related financial procedures in respect of certain agreements signed by project personnel. The outcome of the audit was that the series of actions taken by former project personnel demonstrated poor performance and lack of due care in the exercise of management functions, as well as disregard for internal control procedures. It was noted that (a) certain project personnel signed donor agreements and implemented related activities without any authorization; and (b) the former chief technical adviser used an individual bank account which he established, without authority, for funds received under such donor agreements and for project disbursements and transactions under subcontract agreements.

9. For both audits of GEF/SGP country allocations BOT/98/G52 and MAR/98/G52, the overall level of internal control is considered to be partially satisfactory. In the case of BOT/98/G52, however, a significant issue (assessed as deficient) pertains to a weakness in financial reporting where both grant and operating expenditure for 2001 and for the period January to October 2002 were materially misstated in UNOPS project accounts. In the case of MAR/98/G52, a serious concern (also assessed as deficient) is a conflict of interest issue regarding the membership of the national coordinator to an association, which is a beneficiary of grant funds. The status of this association as a non-governmental organization (NGOs) is questionable because the GEF/SGP guidelines state that grants may only be made to NGOs and community-based organizations for activities in GEF focal areas.

IV. Audit of management service agreement activities

10. As in previous years, OAPR conducted financial audits of MSA activities implemented by UNOPS under letters of agreement between the borrowing governments and UNDP with respect to activities financed from World Bank loans. In 2002, audits were undertaken for six MSA activities, with total expenditure of $6.8 million in 2001 and $5.1 million in 2000 for MSA TUR/95/R01. In each of these audits, the opinion was expressed that the "financial statements present fairly the financial position [...] as at 31 December 2001 and the results for the financial period then ended. The transactions were in accordance with the relevant legislative authority in all material respects".

11. A financial audit was also carried out for an MSA activity as required under the memorandum of agreement between Pakistan and UNDP for management and other support services to be provided by UNOPS under the National Drainage Programme (PAK/99/R71), which is financed by the Japan Bank for International Cooperation (JBIC). The audit opinion expressed in the related report was qualified with respect to items relating to the management fee and the travel charges of the UNOPS Portfolio Manager. Highlighted in the report were the need to define the basis on which the fee was to be calculated and the need to resolve budgetary requirements on travel costs with the Government.

V. Audit recommendations

12. The audit reports issued in 2002 contained 135 recommendations. Of these, 51 were in the area of administration (which included contracts and procurement), 36 in finance, 19 in programme, 16 in personnel, 11 in organization and two in the area of policy. It should be noted that as a result of the special nature and purpose of the reports on the audit of MSAs financed by the World Bank, those six reports do not contain recommendations. The report on the audit of MSA activity financed by JBIC similarly did not contain recommendations.

13. Based on an arrangement between UNOPS and OAPR, the UNOPS organizational units concerned provided their written comments on the contents of the draft audit reports, with an account of actions taken, or contemplated to be taken, to implement the recommendations contained in the reports. The timeliness of UNOPS action units in providing comments, while mostly surpassing the three-week time limit, is still considered on the whole acceptable, in light of the reduction in UNOPS staffing capacity as a result of the unusual financial difficulties which the organization experienced during the reporting period.

14. Of the total of 135 recommendations made in 2002, UNOPS provided its comments on all 135 recommendations. There was only one instance where UNOPS did not agree with a recommendation. In general, the comments indicated that actions have been taken or are being taken to address the audit issues and recommendations.